IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1974

No. 74-1399

Kentucky Central Life Insurance Co.,
A Kentucky Corporation,
Petitioner

v.

Leslie Karen Myers, Individually and
as next friend for Michael Myers,
a minor, a citizen of Texas,
Respondent

PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

Will D. Davis
200 Perry-Brooks Building
Austin, Texas 78701

Dudley D. McCalla
200 Perry-Brooks Building
Austin, Texas 78701

Thomas S. Goggan III
907 Brown Building
Austin, Texas 78701

May 6, 1975

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Kentucky Central Life Insurance Company prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fifth Circuit 506 F.2d 1054 filed in the above entitled case on January 6, 1975, and the order overruling the Petition for Rehearing entered on February 6, 1975, 508 F.2d 842.

OPINIONS BELOW

The District Court Opinion is included herein in Appendix A, infra. This Opinion is reported at —— F. Supp. —— (W.D. Tex., 1974). The Fifth Circuit Opinion is included herein in Appendix A, infra, and is reported at 508 F.2d 842.

JURISDICTION

The judgment of the Fifth Circuit was filed on January 6, 1975. A timely Petition for Rehearing was overruled on February 6, 1975. The jurisdiction of this Court is invoked under 28 USC § 1254 (1). The basis of jurisdiction in the District Court was 28 USC § 1332 (a).

QUESTIONS PRESENTED

1. Did the Court of Appeals err in apparently holding that the mere deposit of checks, which are subsequently dishonored, coupled with internal accounting practices, constitutes unconditional acceptance of such checks as payment of insurance policy premiums when the contract between the parties expressly provides otherwise?

2. Did the Court of Appeals err in apparently

holding that an insurance company is estopped to assert the lapse of a policy upon dishonor of monthly premium checks by failure to inform the policyholder of reversion of the premium paying period to an annual period, when the contracts provide for lapse of the policy, not change in the frequency of payments, upon non-payment of premiums?

LOCAL COURT RULES INVOLVED

Fifth Circuit Local Rule 18:

"Summary Calendar. -- (a) Whenever the court, sua sponte or on suggestion of a party, concludes that a case is of such character as not to justify oral argument, the case may be placed on the summary calendar.

(b) A separate summary calendar will be maintained for those cases to be considered without oral argument. Cases will be placed on the summary calendar by the clerk, pursuant to directions from the court.

(c) Notice in writing shall be given to the parties or their counsel of the transfer of the case to the

summary calendar."

Fifth Circuit Local Rule 21:

"Affirmance Without Opinion -- When the court determines that any one or more of the following circumstances exists and is dispositive of a matter submitted to the court for decision: (1) that a judgment of the district court is based on findings of fact which are not clearly erroneous; (2) that the evidence in support of a jury verdict is not insufficient; (3) that the order of an administrative agency is supported by substantial evidence on the record as a whole; (4) that no error of law appears; and the court also determines that an opinion would have no precedential value, the judgment or order may be affirmed or enforced without opinion.

In such case, the court may in its discretion enter either of the following orders: 'AFFIRMED. See Local Rule 21,' or "ENFORCED. See Local Rule 21.'"

PRELIMINARY STATEMENT

This is an action on a life insurance policy. The questions presented are of the greatest importance to the American public and the entire spectrum of the business and financial community, as well as the insurance industry in the United States.

The facts are undisputed. Kentucky Central Life Insurance Company (Kentucky Central) issued a policy insuring the life of Michael Myers (Myers). The premiums on the policy were payable monthly by pre-authorized check.

The pre-authorized checks for two consecutive premium payments were dishonored by Myer's bank due to "insufficient funds." Inasmuch as Myers failed to replace the dishonored draft as requested by Kentucky Central, the policy lapsed by its own terms prior to Myer's death.

As the District Court recognized, there is no question that under these circumstances Kentucky Central could have cancelled Myer's policy, and that forfeiture of an insurance policy may be, when contractually stipulated,

self-executing upon non-payment of premiums.

The initial question presented, then, is whether despite the essentiality of highly sophisticated data processing and internal accounting processes to the conduct of the Nation's trade and commerce, the use of such processes can result in a liability that would not otherwise exist, when the person asserting such liability is neither cognizant of nor prejudiced by the use of such procedures?

In simpler times in the Nation's past insurance premiums were normally paid in cash, and the insurance company would deliver its executed receipt to the policyholder in exchange for the premium. There is no question that in the instant case the policy would be deemed to lapse if the cash premium were not delivered. Certainly an opposite conclusion should not result from the fact that highly developed data processing and accounting procedures, the Federal Reserve System and the United States Mail make it possible and convenient for citizens of Texas to engage in commerce with citizens of Kentucky.

We respectfully submit that this Court should grant certiorari in this case. The issues involved are of great concern not only to the insurance and banking segments of the financial community directly affected, but to all commercial enterprises, the legal rights and liabilities of which are inexplicably intertwined with interstate banking procedures. The issues are also of paramount concern to the millions of Americans whose financial security is based upon their ability to maintain mutually profitable relationships with financially solid insurance companies of national orientation based in distant states.

STATEMENT

The facts in this case are undisputed. Kentucky Central issued the subject policy on the life of Myers on May 1, 1972. The policy provided for automatic lapse upon non-payment of any premium when due (Appendix B). An endorsement attached to the policy provided that the premiums were to be paid monthly by pre-authorized checks drawn on the bank account of Myers. The

pre-authorized check agreement executed by Myers provided that the use of the pre-authorized check plan would in no way alter or amend the provisions of the policy with respect to the termination of such policy upon non-payment of any premium due. The agreement further provided that no premium would be deemed to have been paid unless and until Kentucky Central received actual payment at its home office, and that the company could terminate the pre-authorized check plan immediately upon the dishonor of any check (Appendix C).

The premium due May 1, 1972, was paid in cash. The pre-authorized check for the premium due June 1, 1972, was paid by the Insured's bank in the due course of business. The pre-authorized checks drawn by Kentucky Central on the bank account of Myers for the premium due July 1, 1972, and August 1, 1972, were dishonored by Myers' bank and were returned to the Kentucky Central offices bearing the notation "insufficient funds."

Kentucky Central notified Myers of the dishonor of the July draft on or about August 9, 1972 (Appendix D).

Kentucky Central never received payment in any form from Myers for the monthly premiums which became due subsequent to June 1, 1972, and did not, therefore, attempt to draw a pre-authorized check for the premium which would have become due September 1, 1972, had the prior premiums been paid.

Myers died September 10, 1972.

Kentucky Central made certain internal accounting entries reflecting the event described above. Upon deposit of each pre-authorized check into its depository bank, the company credited its premium income account and debited its cash account. Each draft was then transmitted through regular banking channels to Myers' bank for payment.

Upon notification of dishonor of the July draft, the company issued its draft to its depository bank in an amount equal to all of the dishonored items received by the bank on that particular date. The company credited its cash account, which had been debited on deposit of the draft, and debited its "returned check clearing

account" (account No. 22050). When the company ascertained that this particular item had been dishonored only once and was eligible for re-deposit in accordance with company policies, the draft was again deposited into the home office bank account, and account No. 22050 (returned check clearing account) was credited and cleared. The July pre-authorized check was again transmitted to the Myers' bank for payment.

The July draft was dishonored by Myers' bank a second time, and again the company credited its cash account and debited its returned check clearing account (account No. 22050). It was then determined that since the draft had been twice dishonored it was not eligible for re-deposit, and Myers was notified. Account No. 22050 was credited and cleared, and a debit entry was made to account No. 22054 (returned check account), an account of dishonored checks.

Prior to the company's knowledge of the second dishonor of the July draft, the August draft was deposited and transmitted in the manner described above. The August

draft was also dishonored twice and handled in the same manner as the July draft. A detailed summary of these transactions is contained in Appendix E.

No draft was drawn for the premium which would have become due September 1, 1972, had the prior drafts been paid.

PROCEEDINGS BEFORE THE DISTRICT COURT

The questions of law which Petitioner now seeks to raise before this Court were first raised in the District Court.

The Respondent instituted suit on the policy and the Petitioner defended on the basis that the policy lapsed due to non-payment of premiums.

The only contested issue of fact in the District Court was whether or not Kentucky Central notified Myers of the dishonor of the July draft. (See Exhibit F, Pre-Trial Order, Paragraph IV.)

This fact issue was abandoned by Respondent at trial, the jury previously demanded by Respondent was waived, and the question of the legal significance of the undisputed facts was submitted to the Trial Court.

Respondent's theory of liability in the

District Court was twofold. It was Respondent's first contention, as Petitioner understands it, that the dishonor of the monthly pre-authorized checks caused reversion of the premium paying period to an annual period, and that Kentucky Central is thus estopped to assert lapse by failure to inform Myers of such reversion and of some amount of partial annual premium then allegedly due.

Respondent's second theory was that ". . . the internal accounting procedures of the defendant effected the payment of the premiums due on or about July 2 and August 2, 1972." (Appendix F, Paragraph VI, infra.)

The District Court did not write on Respondent's first theory of liability, but held that Kentucky Central "accepted" the July and August drafts in payment of the premiums, due to its accounting procedures and treatment of the drafts. (See Appendix A, Opinion, infra.)

PROCEEDINGS BEFORE THE FIFTH CIRCUIT

Pursuant to its Local Rule 18, the Fifth

Circuit declined to hear argument in this case and assigned it to its summary calendar. The Court then affirmed the judgment of the District Court without written opinion pursuant to its Local Rule 21. (See Appendix A, infra.)

REASONS FOR GRANTING THE WRIT

I.

The Court of Appeals Has Rendered a Decision in Conflict with Applicable State Law.

II.

The Court of Appeals has Rendered a Decision in Conflict with the Decision of Another Court of Appeals on the Same Matter.

III.

The Court of Appeals Has Rendered a Decision Which Will Result in a Burden on Interstate Commerce.

I. The Court of Appeals Has Rendered a Decision in Conflict with Applicable State Law.

Petitioner is not unmindful of the gargantuan caseload of this Court and its awesome responsibility to the Nation in

cases of the gravest national significance. Petitioner is further cognizant of the Court's increasing reluctance to grant certiorari to correct errors of the inferior federal courts in matters of local law. We respectfully submit that this Court should grant certiorari in this case because of the serious effect of the lower Court decisions on the business operation of Petitioner and the entire business community, and because of the summary nature of the appellate review afforded this case in the Fifth Circuit.

It will doubtlessly be argued by Respondent that this Court should not accept this case because no substantial federal question is presented. The crowded dockets of this Court and the Courts of Appeal perhaps suggest a re-examination of the wisdom and necessity of jurisdiction in the federal courts based upon diversity of citizenship. Nonetheless, as long as the diversity jurisdiction constitutes an integral part of the jurisprudence of our federal system, a case and controversy arising under 28 USC § 1332 (a) should be

of the same dignity before this Court as one arising under the laws of the United States.

It is respectfully pointed out that the Petitioner before this Court, Defendant below, did not choose the federal forum for this litigation. Inasmuch as the Respondent, Plaintiff below, chose the federal forum, she should not be heard to complain of thorough and effective federal appellate review on the ground that the case turns on a point of state law.

We have no doubt that had this case been litigated in the Courts of the State of Texas the judgment would have been the opposite of that entered by the U. S. District Court. The Supreme Court of Texas has consistently held that the deposit of a check in the bank for collection does not constitute acceptance of the same in payment for the premium, where payment of the check is afterwards refused by the bank upon which it was drawn. Texas Mutual Life Insurance Ass'n v. Smartt, 114 S.W. 2d 528 (Tex. Sup. Ct. 1938), National Aid Life Ass'n. v. Horne, 155 S.W. 2d 910, (Tex. Sup. Ct. 1941), Texas

Mut. Life Ins. Ass'n. v. Tolbert, 136 S.W. 2d 584 (Tex. Sup. Ct. 1940).

It is further well established in Texas that the internal accounting procedures of an insurance company, unknown to the alleged insured, cannot alter the clear terms of the policy and result in liability where none otherwise exists. See also Southie House v. Grand Lodge, Colored Knights of Phythias of Texas, 48 S.W. 2d 674 (Tex. Civ. App. 1932, no writ hist).

As is readily apparent from an examination of the foregoing authorities, the Supreme Court of Texas has insistently and consistently disregarded such superficialities as the status of the insurer's books on a given date and has focused on the fundamental question of whether or not the premium was, in fact, paid.

The net effect of these accounting transactions in the instant case was to withdraw the amounts previously debited to the home office bank account upon deposit of the dishonored drafts, and to debit these amounts into a suspense account No. 22054. Thus the District Court concluded that at the

time of Myers' death he "owed" the company $29.60. Herein lies the essential fallacy of the District Court's reasoning. The Court's analysis rests upon the tacit premise that there is an obligation on Myers to pay the premium and keep the policy in force. Thus, apparently reasoned the Court, upon the dishonor of the drafts Myers "owed" the company $29.60. Since Myers owed the company the premium, the company owed Myers the proceeds of the policy.

The problem with this analysis is that Myers was under no obligation to pay the premiums and keep the policy in force. He had an option each and every month to either maintain a bank balance sufficient to pay the pre-authorized checks and keep the policy, or to let the pre-authorized checks bounce and lose the policy. Clearly in this instance Myers opted for the latter. Thus it is clearly erroneous to hold that Myers owed $29.60 to the company at the time of his death. There was absolutely no obligation on Myers' part either before or after the dishonor of the checks to pay this sum to Kentucky Central Life Insurance

Company,

Under the reasoning of the District Court the insurance company could have continued to unsuccessfully draft Myers' account for a period of months or even years and then present Myers with a bill for accrued premiums. The District Court further implies that such an obligation could be collected by the company by suit and judgment. It is inconceivable to the Petitioner that this Court, or any Court, would uphold a judgment against Myers or his estate on the theory advanced by the District Court. But the Fifth Circuit's affirmance of the judgment against Kentucky Central must necessarily rest upon the same reasoning.

There is a conceptual contradiction within the opinion of the District Court. At the beginning of page three of the Opinion, the Court presented the problem as follows:

> "Thus, the insurance company clearly could have cancelled Myers' policy. The question is whether Kentucky Central actually did cancel the policy, or if it accepted

> the July and August pre-authorized checks in payment for the premiums for those months."

Apparently, the Court had no problem with the company's right to declare a forfeiture prior to Myers' death. The inquiry, as posed by the Court, appears to be whether the company did cancel the policy.

The Court then recognizes the substantive law of Texas that forfeiture of the benefits of an insurance policy may be, when contractually stipulated, self-executing upon non-payment of premiums. Thus, given the Court's conclusion that the policy could have been forfeited for default in premium payment, and given the self-executing provision in the instant case, the conclusion is inescapable that the policy automatically lapsed upon non-payment of premiums.

The District Court relied on Harris v. Glen Falls Group, 478 S.W. 2d 561 (Tex. Civ. App. Corpus Christi 1972, writ ref'd. n.r.e.); Texas Mut. Life Ins. Ass'n. v. Love, 66 S.W. 2d 424, 426 (Tex. Civ. App. Beaumont 1933, writ dism'd); and Pardee

v. Universal Life Insurance Co., 170 S.W. 2d 852 (Tex. Civ. App., Waco 1943, no writ), for the proposition that retention of the pre-authorized checks constituted acceptance. It is respectfully submitted that the Court's reliance upon the above authorities is misplaced.

Harris v. Glen Falls Group, supra, involved a physical damage casualty policy upon which the premium was to be paid by installment note. The policy contained an unconditional recitation that the property was insured from February 24, 1969, until February 24, 1972. Neither the policy nor the note provided for suspension of coverage upon default of the Insured in payments upon the promissory note. The Court refused to read a limitation of liability into the policy and held that the property was insured as recited in the policy. Compare Jefferson Standard Life Ins. Co. v. Hicks, 264 S.W. 1033 (Tex. Civ. App., Beaumont 1924, writ dism'd).

The decision in Texas Mut. Life Ass'n. v. Love, supra, is also inapplicable to the case at bar. In the Love case the insur-

ance company received a personal check executed by the Decedent or his wife for the payment of the assessment due on the policy. The check was subsequently dishonored, and the insurance company retained the check, rather than returning it to the Decedent. The Court held that by retention of the check the company had accepted it as payment.

There are crucial distinctions between Love and the instant case. The Court noted in Love that there was nothing in the notice, the policy, nor the by-laws to the effect that a dishonored check would operate as a forfeiture of the policy. The Court noted with approval the statement made in Northwestern Life Assur. Co. v. Sturdivant, 24 Tex. Civ. App. 331, 59 S.W. 61, 62, that it would be incumbent on the company, if it desired to retain its right under the contract to forfeit the policy, to stipulate that the check would be without effect upon the contract, unless paid in due course. Compare Commonwealth Casualty & Ins. Co. v. Stephens, 150 S.W. 2d (Tex. Civ. App., Waco 1941, no writ).

The Respondent's reliance on Pardee v. Universal Life Insurance Co., 170 S.W. 2d 852 (Tex. Civ. App., Waco 1943, no writ), is also misplaced. The Pardee case was decided adversely to the Plaintiff on the basis of fraud, and the Court expressly declined to pass on whether the insurer's agent was authorized to unconditionally accept the beneficiary's check in payment of the premium. The Court's dicta with respect to the effect of payment of premiums by dishonored draft is conditioned upon the insurer's acceptance of payment on that basis and the absence of contractual stipulations to the contrary. Compare Humphries v. Colorado Life Co., 170 S.W. 2d 315 (Tex. Civ. App., El Paso, 1942, writ ref'd.).

II. The Court of Appeals has Rendered a Decision in Conflict with the Decision of Another Court of Appeals on the Same Matter.

The judgment below conflicts with a decision reached by the Court of Appeals for the Ninth Circuit, and conflicts in principle with a decision of another panel of the Fifth Circuit.

The District Court apparently based its imposition of liability in whole or in part on the fact that the company re-depositied the August draft for collection after its issuance of the August 9, 1972, notice to Myers.

It was the company's standard practice to re-deposit an insufficient funds draft one time. The July draft was re-deposited once after its initial dishonor. The August draft was initially deposited on August 2, 1972, prior to the Company's knowledge on August 7, 1972, of the second dishonor of the July draft. Thus on August 9, 1972, the Company knew that the July draft had been twice dishonored, and the fate of the August draft was unknown. At this point the Company reacted in the most reasonable way possible, by sending Myers a notice stating that the July draft had been dishonored and requesting a replacement.

On August 17, 1972, the Company learned that the August draft had been dishonored. The draft was handled in a routine manner by clerical personnel, and was re-deposited because it had only been dishonored once.

The question thus becomes whether the mere act of sending the draft through for collection a second time can be the basis for liability when the draft dishonored the second time. This precise question was squarely faced in Bigjoe v. Pioneer American Insurance Company, 446 F. 2d. 28 (Ninth Circuit 1971). The Court, basing its decision on both Texas and Washington law, held that even if the re-deposit of a worthless check amounts to a waiver or estoppel, if the check is again dishonored there is a second lapse. Thus the re-deposit can only be a basis for liability if the instrument is actually paid the second time.

In the instant case the August draft was dishonored after the re-deposit, and Myers ignored the August 9 request for a replacement check.

Thus the holding in this case is in conflict with that of the Ninth Circuit in Bigjoe, supra. Furthermore, the result in this case apparently is in conflict with the holding of another panel of this Court in Blanton v. John Hancock Mutual Life Ins. Co., 345 F. Supp. 168, (D.C. Tex. 1971), affirmed 463 F.2d 421 (Fifth Circuit, 1972).

Under the reasoning of the Court in Blanton there would be no recovery in this case even if the August draft had been paid after the re-deposit on August 22, 1972. If the draft had subsequently cleared, that fourteen dollars and eighty cents ($14.80) would have been applied to the delinquent July premium. This would have left the August premium in default, and the grace period would have expired on or about September 2, 1972. As Myers died on September 10, 1972, there would have been no coverage. This result can only have been avoided by Myers' sending a replacement payment pursuant to the notice of August 9, 1972.

III. The Court of Appeals Has Rendered a Decision Which Will Result in a Burden on Interstate Commerce.

It is seriously submitted that the judgment below will lead to confusion in interstate banking transactions at least within the geographic boundaries of the Fifth Circuit. Certainly the rights and liabilities of individuals and commercial establishments cannot rest on the tentative status of accounting entries while checks

and drafts run their natural course through the long distance banking channels necessary to the proper functioning of interstate commerce.

CONCLUSION

Because the resolution of the serious questions raised by the decisions of the courts below is important to the proper functioning of interstate commerce:

We respectfully submit that the Court should grant Petitioner's prayer for a Writ of Certiorari.

Will D. Davis
200 Perry-Brooks Building
Austin, Texas 78701

Dudley D. McCalla
200 Perry-Brooks Building
Austin, Texas 78701

Thomas S. Goggan III
907 Brown Building
Austin, Texas 78701

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APPENDIX